CETC can receive the same support per-line as the ILEC, without having the obligation to serve the entire ILEC study area.

In addition, ITTA previously has recommended that, like ILECs, CETCs should submit actual cost data to justify the amount of support they receive. The Joint Board recently recognized the impropriety of basing CETC support on ILEC's costs in a recommended decision submitted to the Commission in this proceeding.[26] Specifically, the Joint Board stated:

> For areas served by rural carriers, we are concerned that funding a competitive ETC based on the incumbent LEC's embedded costs *may not be the most economically rational method for calculating support*. . . . We agree that universal service payments should not distort the development of nascent competitive markets. Universal service support should neither incent nor discourage competitive entry.[27]

CETCs should be required to adopt reasonable standardized accounting methods to submit their costs in a uniform manner to the Universal Service Administrative Corporation ("USAC"). Most CETCs are established carriers, and as such they should not find it burdensome to track their costs or disclose their financial records related to these areas – this is likely something they already do, for the benefit of their investors. But even if some effort is required by the CETC to provide documentation of costs, it seems to be a small concession in order to protect the integrity of the universal service fund. ITTA does not advocate that *all* competitive carriers submit cost data; but competitive carriers that seek to obtain universal service support should demonstrate that they are using the support for its intended purposes.[28]

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26 Recommended Decision at ¶ 96.

27 *Id.* (emphasis added).

28 *See* 47 U.S.C. § 254(e).

IV. CONCLUSION

ITTA urges the Joint Board to pursue policies that give priority to the welfare of the nation's most rural communities. For the reasons discussed above, the Joint Board should recommend modifications to the Safety Valve support mechanism as proposed herein, in order to appropriately compensate carriers for the high expenses and substantial investments incurred to rehabilitate acquired exchanges. ITTA also requests that the Joint Board recommend that CETCs should receive universal service support based on their own costs, and not the costs of the ILEC and that reasonable accountability measures be instituted to ensure that funds are distributed appropriately. Adoption of these proposals is critical to promoting telecommunications services in rural America and protecting the viability of the universal service high-cost fund.

Prepared this 9th day of November, 2004.

/s/
David D. Cole
Senior Vice President, Operations Support
CENTURYTEL, INC.

On Behalf of

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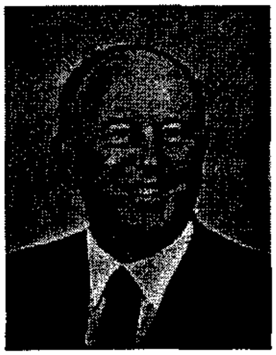
Eugene B. Johnson, Chairman & Chief Executive Officer



Gene Johnson, Chairman and Chief Executive Officer of FairPoint Communications co-founded the company and has been a Director since 1991. Prior to his current position, Mr. Johnson served as Executive Vice President, leading the company's corporate development efforts.

Prior to joining FairPoint, Mr. Johnson was President and sole shareholder of JC&A, Inc., an investment banking and brokerage firm providing services to cable television, telephone and related industries. Before that, he was head of the Mergers and Acquisitions group of Cable Investments, Inc. He has also owned a cable television construction and engineering company and served as COO of Enstar Cable Corp.

Mr. Johnson started his career as a Certified Public Accountant with Haskins and Sells, a predecessor of Deloitte & Touche. A graduate with honors from the University of North Carolina at Charlotte, he achieved the rank of Captain in the U.S. Army and was discharged in 1971.

Today Mr. Johnson serves on the Board of Directors for the Foundation of UNC-Charlotte and as chair of the OPASTCO USF committee. He is a member of the Advisory Council of the Belk College of Business Administration. He has also served on numerous charitable and civic boards and is an Elder in the Presbyterian Church (USA).

STATEMENT OF
GENE JOHNSON
FAIRPOINT COMMUNICATIONS, INC.
CHARLOTTE, NORTH CAROLINA

REPRESENTING
THE ORGANIZATION FOR THE PROMOTION AND ADVANCEMENT OF SMALL TELECOMMUNICATIONS COMPANIES

FEDERAL-STATE JOINT BOARD ON UNIVERSAL SERVICE
EN BANC HEARING ON HIGH-COST UNIVERSAL SERVICE SUPPORT IN AREAS SERVED BY RURAL CARRIERS

PANEL 2: BASIS OF SUPPORT FOR CETCS AND TRANSFERRED EXCHANGES

NASHVILLE, TENNESSEE

NOVEMBER 17, 2004

Competitive eligible telecommunications carriers (CETCs) serving rural telephone company service areas should receive universal service support that is based on their own embedded costs of providing the supported services. This would introduce the same rationality and accountability into the system for these carriers that already exists in the mechanism for rural incumbent local exchange carriers (ILECs). It would also help to sustain the High-Cost program in a manner that enables all ETCs to receive sufficient support to achieve the universal service objectives of the Telecommunications Act of 1996 (1996 Act, the Act).

There is no basis to presume that providing CETCs with the ILEC's identical per-line support amount will provide each CETC with "sufficient," but not excessive support, as called for by Section 254(b)(5) of the Act. In addition, Section 254(b)(5) provides that universal service support be "specific," but allowing CETCs to receive support based on the ILEC's costs is not at all specific to the CETC's own unique costs and circumstances.

Basing CETCs' support on their own embedded costs would also help to ensure compliance with Section 254(e) of the Act, which requires that support be used only for the provision, maintenance and upgrading of facilities and services for which the support is intended. It is clear that the support rural ILECs receive has been used for its intended purposes since it is based almost entirely on their own past actual investment and expense payments, or reductions in other rates. However, it is nearly impossible to discern how competitors use the support they receive when it is based on the incumbent's actual spending record.

When a CETC has lower costs than the ILEC, the identical support rule provides the CETC with an unfair competitive advantage. The fact that a CETC may have lower per-line costs than the ILEC with which it competes does not reflect inefficiency on the part of the ILEC, as wireless carriers and their representatives like to suggest. What it does reflect is the fact that ILECs and CETCs are not at all similarly situated. For instance:

- Competitive carriers are not required to provide ubiquitous service at the time of their request for ETC designation. Rural ILECs, as the recognized carriers of last resort in their service areas, have built ubiquitous, high-quality infrastructure that serves the most remote and highest-cost customers.

- CETCs can potentially be designated for a different, and sometimes significantly smaller service territory than the incumbent's study area. This makes it much easier for a competitive carrier to meet the Act's prerequisites for ETC designation.

- CETCs are typically not held to the same stringent service quality and reliability standards and customer billing requirements generally imposed on ILECs by state commissions. Consequently, while rural ILECs provide high-quality, reliable service, many wireless carriers are still offering what can only be considered a "best effort" service in rural areas.[1]

[1] In its Order approving Cingular's acquisition of AT&T Wireless, the FCC recognized that "there remain qualitative differences between wireless and wireline services" and that "wireline local exchange services may have comparative advantages in reliability, E-911 coverage, ubiquity, and lower-cost unlimited local calling." *See, Applications of AT&T Wireless Services, Inc. and Cingular Wireless Corporation, For Consent to Transfer Control of Licenses and Authorizations,* WT Docket No. 04-70, *Applications of Subsidiaries of T-Mobile USA, Inc. and Subsidiaries of Cingular Wireless Corporation, For Consent to Assignment and Long-Term De Facto Lease of Licenses,* WT Docket No. 04-254, *Applications of Triton PCS License Company, LLC, AT&T Wireless PCS, LLC, and Lafayette Communications Company, LLC, For Consent to Assignment of Licenses,* WT Docket No. 04-323, Memorandum Opinion and Order, FCC 04-255 (rel. Oct. 26, 2004), ¶247, fn. 559.

- Rural ILECs have invested in their networks to accommodate increased demand for network capacity caused by longer holding times when customers connect to the Internet. As a result, customers pay nothing extra when they use their landline connection for Internet access. In contrast, Internet access over a mobile wireless connection, if available, is considered a premium service and customers typically pay an extra charge for the service.[2]

In short, ILECs assume the full obligations of carriers of last resort, offering reliable, high-quality, facilities-based service to everyone in their service areas. CETCs, on the other hand, receive the ILEC's cost-based support, but with significantly fewer expectations and requirements placed on them. Clearly, this constitutes an unfair competitive advantage. It also creates arbitrage incentives for competitive carriers to seek ETC status in areas where they may not have otherwise, causing the size of the Fund to grow unnecessarily.

A recent decision by the District Court of Nemaha County, Kansas, confirms that providing CETCs with the ILEC's cost-based support is not competitively neutral. In *Bluestem Telephone Company, et. al. vs. Kansas Corporation Commission*, the Court overturned a decision by the Kansas Commission that made the state universal service support received by Kansas rural ILECs portable to competitors on a per-line basis. Like the federal rural high-cost mechanism, the state's support system is based on the ILEC's embedded costs. The District Court found that:

> The order of the [Kansas] Commission violates the [state's] statutory requirement to make distributions in a "competitively neutral manner," because the Commission has failed to evaluate all the necessary costs/expense information from all providers. The LEC's [sic] are different in structure and treatment as to rates then the wireless providers. Attempting to establish competitive neutrality without evaluating all providers' costs and expenses, means that the [Kansas] Commission has compared apples and oranges. In order that its orders are

[2] In its Triennial Review Order, the FCC recognized that, among other things, wireless CMRS connections in general do not yet equal traditional landline local loops in their ability to handle data traffic. *See, Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket No. 01-338, *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98, *Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket No. 98-147, Report and Order on Remand and Further Notice of Proposed Rulemaking, 18 FCC Rcd 16978, 17119-17120, ¶230 (2003).

> competitively neutral, the [Kansas] Commission must compare the same units of measurement.[3]

This decision makes clear that there is nothing competitively neutral about requiring rural ILECs to provide extensive data demonstrating above-average costs in order to qualify for support, while not requiring competitors to provide <u>any</u> cost justification for their own receipt of support. If the Joint Board wishes to adhere to the FCC's principle of competitive neutrality,[4] then it must recommend that the Commission immediately eliminate the identical support rule, and begin the process of basing CETCs' support on their own embedded costs.

Providing higher per-line support to the incumbent than to the CETC would not pose a regulatory barrier to competitive entry in rural areas. Mobile wireless providers sought after and obtained spectrum licenses for rural areas, either through auction or lottery, without any expectation of universal service support. These carriers have been successfully serving rural markets for many years now without any high-cost funding.

In the FCC's Ninth CMRS Competition Report, the Commission found that less densely populated counties (100 persons per square mile or less) have an average of 3.7 mobile competitors.[5] The FCC concluded that "CMRS providers are competing effectively in rural areas."[6] Therefore, basing CETCs' support on their own costs will not negatively affect their ability to compete in rural areas. All it will do is eliminate the perverse incentives that currently exist to seek ETC status merely to receive windfall support payments.

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[3] In the District Court of Nemaha County, Kansas, *Bluestem Telephone Company, et. al vs. Kansas Corporation Commission,* Case Nos. 01-C-39, 01-C-40, 03-C-20, and 2004-CV-19, Memorandum Decision (rel. April 30, 2004), p. *10.*

[4] *Federal-State Joint Board on Universal Service,* CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8776, 8801, ¶47.

[5] *Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993; Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services,* CC Docket No. 04-111, Ninth Report, FCC 04-216 (rel. Sept. 28, 2004), ¶109.

When CETCs are able to receive windfalls of support based on the ILEC's costs, it places unnecessary strain on the Fund. This threatens the High-Cost program's sustainability and the ability of all ETCs to receive sufficient support. A review of Fund size projections from the Universal Service Administrative Company (USAC) validates the Joint Board's prior assertion in the Portability Recommended Decision that it is the CETCs that are drivig the rapid growth in the rural High-Cost program.[7]

($Millions)	1st Quarter 2003 Support	1st Quarter 2004 Support	1st Quarter 2005 Support	% Change 1Q 2003 – 1Q 2005	Two-Year Support Increase	% of Total Two-Year Support Increase
Rural High-Cost Support						
ILEC	$603.1	$609.9	$621.6	3.1%	$18.6	16.6%
CETC	$16.6	$75.7	$109.8	560.5%	$93.1	83.4%
Total	**$619.7**	**$685.6**	**$731.4**	**18.0%**	**$111.6**	**100.0%**

Among other things, this chart illustrates that CETCs are responsible for approximately 83 percent of the growth in the rural portion of the High-Cost program, from 1st Quarter 2003 to 1st Quarter 2005.[8] It also shows that over the past two years, the support earmarked for CETCs in rural service areas grew by a multiple of more than six,[9] while support for rural ILECs increased just three percent. It stands to reason, then, that the way to directly address the

[6] *Id.*, ¶111.

[7] *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Recommended Decision, 19 FCC Rcd 4257, 4285, ¶67 (2004) ("Much of this growth [in high-cost support] represents supported wireless connections that supplement, rather than replace, wireline service. Our examination of the record reveals the potential for uncontrolled growth as more and more competitive ETCs are designated in rural and high-cost areas.").

[8] Universal Service Administrative Company, *Federal Universal Service Support Mechanisms Fund Size Projections for the First Quarter 2003* (Nov. 1, 2002), Appendix HC01; Universal Service Administrative Company, *Federal Universal Service Support Mechanisms Fund Size Projections for the First Quarter 2005* (Nov. 2, 2004), Appendix HC01.

[9] The support amounts presented for CETCs reflect both existing CETCs as well as competitive carriers that have ETC applications that are pending. In the past, some wireless carriers and their representatives have argued that it is not appropriate to include support amounts attributable to carriers with pending ETC applications since they have yet to receive any support. However, USAC includes support amounts for yet-to-be-approved CETCs in its fund demand, which determines the contribution factor. Therefore, the inclusion of support amounts for pending CETCs

significant growth in the rural portion of the High-Cost program is to immediately abolish the identical support rule and move toward basing support for CETCs on their own costs. This would effectively eliminate the wasteful payout of windfall support amounts that threaten the Fund's viability while still ensuring that all ETCs receive sufficient support.

OPASTCO recommends that the Joint Board and/or FCC hold industry workshops to develop the accounting mechanisms through which CETCs in rural service areas would be required to report their embedded costs. A chart of accounts should be developed that is appropriate for CETCs in each industry segment (*i.e.*, wireless, wireline, etc.). The Joint Board and FCC should initially focus their attention on developing cost reporting rules for wireless CETCs since they presently receive approximately 95 percent of the projected universal service support going to CETCs in rural service areas.[10]

Obviously, the specific types of costs reported by wireless ETCs and ETCs using other technology platforms will need to differ from the types of costs that LECs are required to report. However, the level of detail required from every ETC, regardless of technology, should be the same. There should be cost reporting parity between ILECs and CETCs. Cost studies should sufficiently rationalize a CETC's costs in a manner that approximates the results obtained by ILEC cost studies.

The Joint Board and Commission may also wish to consider developing an average schedule option for CETCs that would provide these carriers with a choice between submitting their own annual cost study or relying on formulas that would simulate the embedded costs of

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is quite appropriate in this type of analysis, since it is reflected in the contributions that carriers are required to make today.

[10] Approximately $104.3 million, or 95 percent of first quarter 2005 projected universal service support payments for CETCs in rural service areas is going to wireless CETCs, with the remaining $5.5 million, or 5 percent, going to wireline CETCs. These figures are based on a conservative identification of known wireline vs. wireless CETCs listed on USAC's high-cost support projection summaries. *See,* Universal Service Administrative Company,

similarly situated carriers using the same technology. This would afford CETCs the same options as rural ILECs and give them the same opportunity to avoid the administrative costs of developing an annual cost study.

While OPASTCO recognizes that cost accounting mechanisms for CETCs will take some time to develop, that does not mean that the identical support rule should remain in effect until the new cost reporting rules are ready for implementation. During the period of time in which accounting rules are being developed, the Joint Board should recommend the adoption of the interim plan filed by the Rural Telecommunications Associations in the FCC's proceeding on the Joint Board's Portability Recommended Decision.[11] Under this plan, wireless CETCs would receive a "safe harbor" percentage of the rural ILEC's per-line support, with the specific percentage determined by the size of the wireless carrier. The percentages established in the plan are based on the relative cost differences between wireline and wireless carriers as they currently exist. The percentages also acknowledge the fact that large wireless carriers that serve predominantly metropolitan areas and most likely benefit from economies of scale require less support than smaller, mostly rural wireless carriers.

Wireless carriers should be permitted to have their support determined by the safe harbor percentages established in the Associations' plan up until a certain sunset date, to be determined by the FCC. This would give wireless CETCs a transition period to internally adopt the cost accounting procedures established for them. After the sunset date, wireless CETCs would be required to adhere to the cost accounting rules (or use the average schedules) established for

Federal Universal Service Support Mechanisms Fund Size Projections for the First Quarter 2005 (Nov. 2, 2004), Appendix HC01.

[11] *See,* Rural Telecommunications Associations comments in CC Docket No. 96-45 (fil. Aug. 6, 2004); Rural Telecommunications Associations reply comments in CC Docket No. 96-45 (fil. Sept. 20, 2004). The Rural Telecommunications Associations consist of OPASTCO, the Rural Independent Competitive Alliance (RICA), and the Rural Telecommunications Group (RTG).

them in order to receive support. Similar transitionary measures and sunset dates should be established for wireline CETCs and CETCs utilizing other technology platforms.

Even though it may presently be difficult for some CETCs to demonstrate their costs, this is not a legitimate reason for exempting these carriers from having to perform cost studies in order to qualify for support. Carriers that seek *high-cost* funding should be required to demonstrate that their costs are above average and exceed a certain threshold. Otherwise, the support they receive will most likely be more than just "sufficient," it will be excessive. The system needs to be accountable to those who ultimately fund it – ratepayers nationwide.

Biography of Denise Parrish
For the
En Banc Hearing of November 17, 2004

Denise Parrish is the Deputy Administrator of the Wyoming Office of Consumer Advocate. She has spent 27 years in the field of utility regulation, having work for the Michigan Public Service Commission, the Colorado Public Utilities Commission, the Arizona Residential Utility Consumer Office, the Arizona Corporations Commission, the Wyoming Public Service Commission, and the Wyoming Office of Consumer Advocate. Ms. Parrish is a former chair of the NARUC Staff Subcommittee on Accounting and Finance and is currently a member of the NASUCA Tax and Accounting Committee. For the past three years, Ms. Parrish has been a member of the faculty of the Michigan State University Institute of Public Utilities (Camp NARUC). In 2004, her work experiences were expanded to include international regulatory projects, including: discussions with the Nigerian Communications Commission on regulatory accounting matters and the development of a draft uniform system of accounts, teaching at a seminar on regulatory accounting and auditing sponsored by the International Telecommunications Union, and participating in a Croatian conference of the Energy Regulators Regional Association. Ms. Parrish has a Bachelor of Arts degree in Accounting from Michigan State University and is listed in the 2004/2005 edition of Marquis' Who's Who of American Women

STATEMENT OF DENISE PARRISH
ON BEHALF OF THE
NATIONAL ASSOCIATION OF STATE UTILITY CONSUMER ADVOCATES

REGARDING THE ISSUES OF HIGH-COST SERVICE SUPPORT FOR AREAS SERVED BY RURAL CARRIERS AND RELATED ISSUES

NOVEMBER 17, 2004
EN BANC HEARING OF THE FEDERAL-STATE JOINT BOARD ON UNIVERSAL SERVICE

<u>*Basic Principles*</u>

NASUCA very much appreciates the opportunity to provide input into the Joint Board's recommendation relative to high cost support funding for rural carriers. We agree that this review of the appropriate funding method is important and necessary. Yet, we urge the Joint Board to keep certain fundamental principles in mind as it undertakes the development of its recommendations. These principles, which are clearly spelled out in Section 254 of the Act, must not be lost in the discussions about today's market structures, new technologies, competitive by-pass, and growth rates. While each of those items has a place in the discussion, they are secondary to the fundamentals. These fundamental principles are beautifully simple in concept:

- affordability of basic communications services by all, including the economically disadvantaged;
- ubiquitous access to quality services throughout the nation;
- equitable and reasonably comparable treatment of urban and rural customers;

- a system of support that can be counted on to keep and better the high-quality and reliable telephone network that has been established throughout America; and
- a system of distributing support that neither advantages nor disadvantages emerging technologies or competitors in meeting basic communications needs.

The Joint Board need not select one of these principles at the expense of another. Rather, we believe the Joint Board can, and must, find a way to mesh each of these principles so that they become complimentary to one another. We hope our suggestions will assist the Joint Board in this formidable task.

NASUCA's Formal Comments

On October 15, 2004, NASCA filed formal comments in this matter. These comments encourage:

- the continued transition to economic costs by rural carriers that have 50,000 access lines or more through a five-year phase-in to a forward-looking cost basis of support;
- maintaining embedded costs, with checks and balances, as the basis of support for the smallest of the rural carriers;
- refinement of the definition of rural carrier including combining the entirety of the service area in a state for a carrier when determining its rural or non-rural status; and

- a leveling of the playing field such that CLECs receive support based on their own costs, rather than the costs of another carrier.

My comments are intended to be supplemental and complementary to those more formal and complete comments of NASUCA submitted in this matter.

What methodology should the Commission use to calculate the basis of support for eligible telecommunications carriers?

Does one size fit all?

Before determining the computational methods to be used in distributing support to ETCs, the Joint Board should consider whether *one size fits all* or whether there is justification to consider different support schemes for different sizes of carriers, different types of carriers, and carriers located in geographically diverse areas. We disagree with those who urge that one system can be made to fit all, whether the fit is natural or forced. However, in examining the general characteristics of carriers, including economies of scales, deployment costs, overheads, and other cost drivers, we conclude that three categories of carriers – and hence, three methods of computing support – are adequate and appropriate for today's market.

Non-rural carriers should continue to be provided support on the basis of the Commission's synthesis model that estimates forward-looking economic costs for each area of service throughout the nation. Rural carriers serving larger numbers of customers should be transitioned to a forward-looking cost method, but only if there is recognition that the model and support mechanism needs modification and updating Rural carriers serving a smaller number of customers should be allowed to remain on an embedded cost based system, with some safeguards put in place to makes sure that the sky is not the limit in terms of federal support.

Redefining Rural

When placing carriers into one of our three recommended categories, we suggest that the characteristics of what constitutes a rural or non-rural carrier be redefined. Holding companies having multiple operations in one state should not be permitted to maintain separate study areas endlessly to the point of maximizing support. Holding companies are able to take advantage of their purchasing power and effectuate economies of scale relative to certain administrative and operating costs, as well as relative to the cost of material. In light of this, we encourage the redefinition of rural such that all of the related and subsidiary operations of a company are consolidated when performing the line count to determine if it qualifies as a small rural carrier, a large rural carrier, or a non-rural carrier. A new category of rural carrier should be created for those providers with more than 50,000 customers in a state.

In encouraging the consolidation of the multiple but related operations within a state for the purposes of defining rural carriers, we are not suggesting that these larger carriers may not need support. Their cost of providing service may still be driven upward by low-density service areas or rocky terrain. But, it is these actual cost characteristics that should be recognized in the level of support they are provided rather than maintenance of artificial study area designations in order to maximize federal support.

NASUCA urges an additional refinement to the definition of rural carrier, for USF purposes. As just described, we encourage that rural carriers be defined as either larger rural carriers (those who serve a total of 50,000 or more lines in a state) or smaller rural carriers (those who serve less than 50,000 lines in a state). But, when determining whether a carrier is rural at all, the current definition should be narrowed. In looking at the current definition at Section 153(37) of the Act, a carrier is defined as rural if any one of several events listed occurs. For example, a carrier can have less than 15% of its access lines in communities of more than 50,000 on February 8, 1996 and be defined as rural, even though it may have several million total lines! To rectify this situation, NASUCA is recommending that Section 153(37) (B), (C), and (D) all apply for a carrier to be classified as rural. By making this change, there would be assurance that the territory served is rural <u>and</u> the carriers are smaller in total size. Once a carrier is defined as rural, it is then categorized as either a larger or a smaller rural carrier.

By redefining the characteristics of a rural carrier, the Joint Board, and ultimately the Commission, can better target the fund to those carriers with the highest need for support. Forward-looking cost models have currently proven to be the most problematic when attempting to measure the costs, customer locations and efficiencies of the most rural and smallest providers. By beginning additional transitions away from embedded-based support with the larger rural carriers, any problems that do exist will be minimized.

Furthermore, the costs of these larger rural carriers are more similar to those already being measured in the model for non-rural carriers than they are to the costs of the smaller, more high-cost, less dense rural carriers. Also, the costs of this larger rural carriers group appears to be more homogenous than are the costs of the smallest carriers.

The use of such a model to calculate the level of support to the carrier then blends the principles of providing support where it is needed (affordability) and minimization of the fund (sustainability). The model furthers the provision of quality services by using inputs based on modern technologies that allow for services that meet today's customers' expectations. Finally, the model would be technologically and competitively neutral since the model would reflect a reasonably efficient level of operations. This efficiency could then be achieved through the deployment of any one of multiple technologies. Assuming a proper measurement of the efficiencies and costs of today's carriers by the model, support should be predictable and sufficient.

Reexamining and Updating the Model Inputs

One key aspect of NASUCA's recommendation is that the model's inputs must be reexamined, revised, and updated during the five-year period we propose for transitioning larger rural carriers from an embedded cost system to a forward-looking cost system. We recommend that the current Commission synthesis model become the starting point for the development of a model for measuring appropriate distributions to the larger rural incumbent ETCs. We acknowledge and share the concerns of several of the Joint Board members that the model – as it stands today – does not work for either large or small rural carriers. However, we are hopeful that with an update and reexamination of the customer locations, model assumptions on operating costs, and model assumptions on per unit investments, the results will provide the efficiency incentives that are intended while also providing sufficient support levels. NASUCA's support for a transition to forward-looking costs is dependent upon the re-look at the model inputs and assumptions. Without this provision, we too would continue to have serious doubts about the appropriateness of its use for any rural company – whether large or small.

Statewide Average versus Individual Carrier Costs

We also recommend a change in the granularity of the model outputs and the use of those outputs for making support distributions. Rather than expanding the current method of benchmarking against statewide average costs, we recommend that the forward-looking costs determined by the model for each carrier (based upon inputs representing individual carriers characteristics) be measured against a benchmark. If a carrier has more than one service territory in a state, those service areas would be combined for the purpose of determining distributions, but the costs for one carrier would not be combined with those of another provider when determining its share of high-cost support.

As to the benchmark against which an individual carriers' model output costs are to be applied, NASUCA has not yet made a recommendation. However, we do suggest that the Joint Board carefully examine whether the current benchmark for non-rural providers should also be applied to the rural carriers. Some updated model runs, some average pricing information, and an examination of total rural customer bills (including more long distance than that used by most urban customers) would be useful as the Joint Board develops its recommendation on the appropriate benchmark for rural customers. Many continue to be concerned that the current benchmark for urban companies does not comply with the reasonable comparability test, and if this is true, we suspect that the reasonably comparable test would be even more compromised if the same benchmark were applied to rural companies. This is an area that needs more data and more discussion.

Small Carriers' Embedded Cost Support

NASUCA proposes that companies with fewer than 50,000 access lines remain under a support mechanism based on embedded costs for now. We also propose that further study should be done looking toward the ultimate transition of all companies to a forward-looking cost model. However, the transition of the smallest rural carriers from embedded-cost based support should only occur once re-examination and re-testing of the model with rural inputs and reasonable geographic customer data has been used in the forward-looking cost model. We must be assured that the support coming from such a transition will be sufficient to keep end user rates affordable and that the quality of service will not suffer. We must not become a nation of haves and have-nots for the sake of economic theory.

On the other hand, we agree that the current embedded system may offer opportunities for smaller companies to abuse the system through the use of gold-plating networks or the lack of cost controls. Hence, we suggest that some there be some control placed on the level of overheads and administrative costs that are included in the computation of high-cost support. One method of doing this is by arriving at a *best-practices benchmark.* This benchmark could then become a safe-harbor where, for example, if a company's overheads were within a designated range, they would be deemed reasonable for inclusion in the support calculation. (The Joint Board should further examine the reasonable basis for such a benchmark, whether it be on a per customer basis, a dollar of revenue basis, a dollar of investment basis, or some combination thereof.) However, we are reluctant to endorse a system where all costs above such a benchmark are deemed to be unreasonable without even an opportunity for further explanation or support.

Should a competitor receive support based on the incumbent carrier's costs or its own costs?

Cost-Based Support for CETCs

NASUCA recommends that a CLEC receive support based on its own costs rather than based on the incumbent carrier's costs. Additionally, the CETC should only receive support if its costs are high enough to exceed the established benchmark such that support is necessary for it to continue to provide service in the rural market. It should not be entitled to receive high-cost support simply because another carrier receives such support. Experience has shown that support is not necessarily required to stimulate new investment in a rural market by a CETC, and thus, the support is simply a bonus revenue stream that is funded with customer money. Build-out often occurs, especially in rural cellular markets, without any assurance that ETC status will be granted. If ETC status is granted, shareholders benefit but customers rarely, if ever, see a change in that competitive provider's price. Continuing to provide money to CETC's who show no need for the funds fails the test of providing a sustainable fund. It also fails the test of maintaining affordable rates for all customers as customers are required to pay more and more to support a fund that is growing unnecessarily.

Some may argue that requiring CETC's to provide cost data in order to receive public support is a move toward heavy-handed regulation and away from free-market economics. We disagree. The NASUCA proposal relative to fund distributions *would not require* a competitive carrier to provide any cost data to regulators and would not require any regulatory approvals *unless* it was asking for money that is coming from a publicly administered pool of money funded by all customers – not just its own. If a company is to receive high-cost funds, it should be willing to show it has a need for the money and that providing such funds is not in violation of the public interest. If it chooses not to share such information, it should fund its operations from shareholder money and revenues from its own customers.

We recommend one other computational limitation on the support provided to CETCs. Support must be capped at the incumbent carrier's level of support in order to ensure a sustainable high-cost program and mitigate the risk of uneconomic support for very high-cost competitive carriers. ILECs continue to serve as the only reliable carrier of last resort. If a competitive provider is unable to offer services at a cost equal to or less than the costs incurred by the incumbent provider, it is not in the public interest to support that provider's higher costs. Competition is not served by allowing inefficient competitive providers to remain in an area at the expense of the American public. Competitive providers should not receive support that exceeds the per line support provided to the incumbent carrier.

The universal service fund should not be used to advance or promote competitive carriers market entry. It should be competitively neutral which means that it should neither advantage nor disadvantage any carrier serving the market. Providing an incentive for the inefficient carrier to enter the market is not competitively neutral but instead advantages the CETC. This practice should stop.

What level of support should be provided to carriers who acquire exchanges from an unaffiliated carrier?

NASUCA did not take a position on this question in its October 15, 2004 comments. However, several principles stated in response to other aspects of the Joint Board's questions are also applicable in response to the issue of support for acquired exchanges. Carriers should not be provided an incentive to purchase exchanges just to increase their profit levels at the expense of the high-cost fund. But, if exchanges purchased are deemed to be in the public interest (in that quality of service will improve, affordability and accessibility of services will increase, or other fundamental public interest standards are met) then they should receive similar treatment as existing exchanges. Administrative cost safeguards would be applied. Consolidation of study areas within a state would occur for purposes of computing high-cost support. Rates and services should continue to be subject to the reasonably comparable test.

Again, NASUCA is appreciative of the opportunity to provide input into this proceeding. We look forward to answering any questions you may have about our recommendations at the en banc hearing.

JOINT BOARD EN BANC HEARING

Wednesday, November 17, 2004

Panel 1

Good afternoon. I want to thank the members of the Joint Board for putting this Hearing together, and allowing me to participate on this Panel. Before I address the questions asked of this Panel, I'd like to put the issues of this proceeding into the appropriate perspective.

In anticipation of the end on June 30, 2006 of the "interim plan" adopted in the *Rural Task Force Order*, the Commission asked the Joint Board to undertake a review of what measures should succeed the RTF plan and how rural and non-rural high-cost support mechanisms should function together, the so-called "harmonization" of rural and non-rural support. Specifically, this Panel has been asked to comment on the cost standard for measuring rural carrier support, and whether the standard should be forward-looking economic costs as is the case with non-rural support, or whether it should continue to be based on embedded costs.

But before limited resources are expended on this effort, there is another kind of harmonization that *urgently* requires the Commission's attention. I speak, obviously, of the critical need to harmonize the disparate rules under which carriers compensate each other for terminating each other's traffic. The patchwork of different intercarrier compensation schemes, resulting from legacy regulatory classifications such as "local",